No. 86-751

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1986

ARKANSAS BEST CORPORATION AND SUBSIDIARIES,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

BRIEF OF KRAFT, INC. AS AMICUS CURIAE IN OPPOSITION TO POSITION OF RESPONDENT

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QUESTION PRESENTED

Should *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 76 S.Ct. 20, 100 L.Ed. 29 (1955), and *Commissioner v. Gillette Motor Transport Co.*, 364 U.S. 130, 80 S.Ct. 1497, 4 L.Ed.2d 1617 (1960), be overruled so that all transactions in stock are to be regarded as capital asset transactions under Section 1221 of the Internal Revenue Code of 1954 (and 1986) or should the Court continue to give effect to the original legislative intent of the capital asset provision and recognize the difference between property acquired for business purposes and property acquired for investment purposes?

TABLE OF CONTENTS

	Page
INTEREST OF KRAFT, INC.	1
SUMMARY OF ARGUMENT	2
ARGUMENT	
I. RESPONDENT'S ARGUMENT IN *CORN PRODUCTS* WAS ACCEPTED BY THIS COURT	3
II. *CORN PRODUCTS* IS CONSISTENT WITH DECISIONS WHICH APPLY THE INTERNAL REVENUE CODE IN HARMONY WITH THE UNDERLYING CONGRESSIONAL INTENT	8
III. *CORN PRODUCTS* IS CONSISTENT WITH THE LEGISLATIVE HISTORY OF SECTION 1221 AND ITS PREDECESSOR PROVISIONS	11
IV. DESPITE FREQUENT LEGISLATIVE ACTIVITY CONCERNING THE DEFINITION OF "CAPITAL ASSETS", NO EFFORT HAS BEEN MADE TO REFORM OR RESTRICT THE SCOPE OF *CORN PRODUCTS*	15
V. THE DECISION OF THE EIGHTH CIRCUIT IN *ARKANSAS BEST* IS IN ERROR	16
CONCLUSION	19

TABLE OF AUTHORITIES

Cases: *Page*

American Automobile Assn. v. United States, 367 U.S. 687, 81 S.Ct. 1727, 6 L.Ed.2d 1109, *reh'g denied*, 368 U.S. 870, 82 S.Ct. 24, 76 L.Ed.2d 70 (1961) 17

Arkansas Best Corporation and Subsidiaries v. Commissioner, 800 F.2d 215 (8th Cir.), *cert. granted*, 94 L.Ed.2d 757, 55 U.S.L.W. 3643 (1986) 2, 7, 16

Burnet v. Harmel, 287 U.S. 103, 53 S.Ct. 74, 77 L.Ed. 199 (1932) 8, 13, 14

Commissioner v. Bagley & Sewall Co., 221 F.2d 944 (2d Cir. 1955) 4, 11

Commissioner v. Brown, 380 U.S. 563, 85 S.Ct. 1162, 14 L.Ed.2d 75 (1965) 6, 17

Commissioner v. Gillette Motor Transport Co., 364 U.S. 130, 80 S.Ct. 1497, 4 L.Ed.2d 1617 (1960) 1, 5-7, 14-16, 18, 19

Commissioner v. National Alfalfa Dehydrating & Milling Co., 417 U.S. 134, 94 S.Ct. 2129, 40 L.Ed.2d 717 (1974) 18

Commissioner v. Western Wine & Liquor Co., 18 T.C. 1090 (1952), *appeal dismissed on government motion*, 205 F.2d 420 (8th Cir. 1953), *acq.*, 1958-1 C.B. 6 . . . . . 4, 7, 11

Corn Products Refining Co. v. Commissioner, 350 U.S. 46, 76 S.Ct. 20, 100 L.Ed. 29, *reh'g denied*, 350 U.S. 943, 76 S.Ct. 297, 100 L.Ed. 823 (1955) 1-11, 13-19

Fribourg Navigation Co. v. Commissioner, 383 U.S. 272, 86 S.Ct. 862, 15 L.Ed.2d 751 (1966) 16, 17

	Page
General Utilities & Operating Co. v. Helvering, 296 U.S. 200, 56 S.Ct. 185, 80 L.Ed. 154 (1935) . . .	15
Gregory v. Helvering, 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596 (1935)	9, 10
Helvering v. Alabama Asphaltic Limestone Co., 315 U.S. 179, 62 S.Ct. 540, 86 L.Ed. 775 (1942)	8-10
Helvering v. Gregory, 69 F.2d 809 (2d Cir. 1934), *aff'd*, *Gregory v. Helvering*, 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596 (1935)	9
Hogg v. Allen, 105 F. Supp. 12 (M.D. Ga. 1952), *aff'd sub nom. Edwards v. Hogg*, 214 F.2d 640 (5th Cir. 1954)	4
Morrison v. Commissioner, 71 T.C. 683 (1979), *aff'd*, 611 F.2d 98 (5th Cir. 1980)	14
Pinellas Ice & Cold Storage Co. v. Commissioner, 287 U.S. 462, 53 S.Ct. 257, 77 L.Ed. 428 (1933)	8
W. W. Windle Co. v. Commissioner, 65 T.C. 694, *appeal dismissed*, 550 F.2d 43 (1st Cir. 1976), *cert. denied*, 431 U.S. 966, 97 S.Ct. 2923, 53 L.Ed.2d 1062 (1977)	8
Waterman, Largen & Co. v. United States, 419 F.2d 845 (Ct. Cl. 1969), *cert. denied*, 400 U.S. 869, 91 S.Ct. 103, 27 L.Ed.2d 109 (1970)	17

Statutes and Regulations:

Internal Revenue Code of 1939, as amended:	
Section 117(a)	11
Section 117(a)(1)	3, 5

	Page
Internal Revenue Code of 1954, as amended:	
Section 311(a)(2)	15
Section 336	15
Section 337	15
Section 368(a)(1)(B)	10
Section 368(a)(2)(B)	10
Section 1221	1, 2, 11, 14-16, 19
Section 1221(2)	14
Section 1221(3)	14
Section 1221(4)	14
Section 1221(5)	14
Revenue Act of 1921, ch. 136, § 206(a)(6), 42 Stat. 233 (1921)	11-13
Revenue Act of 1924, ch. 234, § 208(a), 43 Stat. 263 (1924)	12, 13
Revenue Act of 1934, ch. 277, § 117(b), 48 Stat. 714 (1934)	14
Revenue Act of 1938, ch. 289, § 117(a), 52 Stat. 500 (1938)	14
Revenue Act of 1942, ch. 619, § 151(a), 56 Stat. 846 (1942)	14
Revenue Act of 1950, ch. 994, § 210(a), 64 Stat. 933 (1950)	14
Tax Reform Act of 1969, Pub. L. No. 91-172, § 514(a), 83 Stat. 643 (1969)	14

	Page
Tax Reform Act of 1976, Pub. L. No. 94-455, § 2132(a), 90 Stat. 1925 (1976)	14
Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 505(a), 95 Stat. 338 (1981)	14
Tax Reform Act of 1986, Pub. L. No. 99-514, § 631, 100 Stat. 2085 (1986)	15
Treasury Regulations (26 C.F.R.):	
§ 1.166-6(b)(1)	6
Revenue Rulings:	
Rev. Rul. 58-40, 1958-1 C.B. 275	4, 7
Rev. Rul. 70-64, 1970-1 C.B. 36	7
Rev. Rul. 72-179, 1972-1 C.B. 57	7
Rev. Rul. 72-238, 1972-1 C.B. 65	6, 7
Rev. Rul. 75-13, 1975-1 C.B. 67	7, 8
Rev. Rul. 75-533, 1975-2 C.B. 359	15
Rev. Rul. 78-94, 1978-1 C.B. 58	8
Rev. Rul. 78-414, 1978-2 C.B. 214	8
Proposed Legislation:	
H.R. 6715, 68th Cong., 1st Sess. § 208(a)(8) (1924)	12
Congressional Reports:	
H. REP. No. 179, 68th Cong., 1st Sess. 19 (1924), *reprinted in* 1939-1 (Part 2) C.B. 241, 255	13
H. REP. No. 704, 73d Cong., 2d Sess. 10 (1934), *reprinted in* 1939-1 (Part 2) C.B. 554, 562	14

	Page
H. REP. No. 1385, 73d Cong., 2d Sess. 22 (1934), *reprinted in* 1939-1 (Part 2) C.B. 627, 632	14
H. REP. No. 3124, 81st Cong., 2d Sess. 27 (1950)	14
S. REP. No. 1236, 94th Cong., 2d Sess. 532 (1976)	14
H. REP. No. 215, 97th Cong., 1st Sess. 260 (1981)	14
Other:	
Brief for United States, at 18, 21, 22 and 27, *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 76 S.Ct. 20, 100 L.Ed. 29 (1955)	3, 4, 7, 9-11, 16
Brief for United States, at 17, *Commissioner v. Gillette Motor Transport Co.*, 364 U.S. 130, 80 S.Ct. 1497, 4 L.Ed.2d 1617 (1960)	5
Kraft, Inc. v. United States, No. 804-86T (Cl. Ct. filed Dec. 23, 1986)	2
Surrey, *Definitional Problems in Capital Gains Taxation*, 69 HARV. L. REV. 985 (1956)	10, 11
Miscellaneous:	
Appendix A	3, 4, 7, 9-11, 16
Appendix B	5

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BRIEF OF KRAFT, INC. AS AMICUS CURIAE IN OPPOSITION TO POSITION OF RESPONDENT

INTEREST OF KRAFT, INC.

Kraft, Inc. ("Kraft"), with the consent of the parties, submits this Brief as Amicus Curiae in support of the position that the decisions in *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 76 S.Ct. 20, 100 L.Ed. 29, *reh'g denied*, 350 U.S. 943, 76 S.Ct. 297, 100 L.Ed. 823 (1955), and *Commissioner v. Gillette Motor Transport Co.*, 364 U.S. 130, 80 S.Ct. 1497, 4 L.Ed.2d 1617 (1960), are an essential part of the distinction made in Section 1221 of the Internal Revenue Code of 1954, as originally enacted in

1921, between property acquired and held for investment purposes and property acquired and held for business purposes. Kraft, a Delaware corporation, headquartered in Illinois, is the plaintiff in *Kraft, Inc. v. United States*, No. 804-86T (Cl. Ct. filed Dec. 23, 1986). A decision in the above-titled case may affect Kraft's position in its Claims Court case.

SUMMARY OF ARGUMENT

Amicus Curiae, Kraft, Inc., contends that the decision of the Eighth Circuit Court of Appeals in *Arkansas Best Corporation and Subsidiaries v. Commissioner*, 800 F.2d 215 (8th Cir.), *cert. granted*, 94 L.Ed.2d 757, 55 U.S.L.W. 3643 (1986) is in error. Application of Section 1221 of the Internal Revenue Code of 1954 (and 1986), has not been literally applied except by the Eighth Circuit. *Id.* This Court acknowledged in 1955, at the urging of respondent, the United States, that a business purpose-investment purpose test is a necessary element in applying the ameliorative distinction between capital and ordinary transactions. *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 76 S.Ct. 20, 100 L.Ed. 29 (1955). Although the facts of *Corn Products* suggest to the Eighth Circuit no exception to the statutory language, the arguments made by respondent in *Corn Products* and the positions taken by it subsequent to that decision reflect a much broader and more realistic view of the type of transactions properly excepted from capital gain and loss treatment.

Corn Products is not unlike other decisions which apply provisions of the Internal Revenue Code ("Code") to the substance of a transaction consistent with the purpose of a Code section as articulated by Congress. The *Corn Products* doctrine as enunciated in 1955, at respondent's urging, has become an integral part of the "capital asset" definition first inserted in the Code in 1921. If respondent now wants to change this definition, it should go to Congress and not this Court.

I.

RESPONDENT'S ARGUMENT IN *CORN PRODUCTS* WAS ACCEPTED BY THIS COURT

Corn Products concerned futures contracts, "property [the equivalent] of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year". Section 117(a)(1) of the Internal Revenue Code of 1939, ch. 2, § 117(a), 53 Stat. 50 (1939). Neither respondent nor this Court appeared comfortable with a decision on the ground that the futures contracts were the equivalent of inventory, however. In its brief to this Court in *Corn Products*, filed on October 3, 1955, respondent argued as follows:

> As this Court has indicated, the capital gains provisions must be read in light of their purpose and in the context of the pattern of the income tax law which taxes ordinary income at full rates and grants exceptional treatment to capital gains and losses. So read it becomes evident that *Congress has made it as clear as the limitations of language permit* (short of a detailed enumeration of every conceivable kind of transaction which might be found in every conceivable type of business) *that profits and losses derived from the normal operation of a business are not to receive the special tax considerations reserved for what, generally, may be described as investments.* (Emphasis added.)

Brief for Respondent at 27, *Corn Products*, 350 U.S. 46, Appendix A, *infra*, at A-4.

In this passage, and elsewhere in the same brief, respondent contended that the statutory language of Section 117(a)(1) of the Internal Revenue Code of 1939 was not to be read literally. Relying on a number

of decisions[1] involving the acquisition of securities (bonds and stock) purchased to secure a business as opposed to an investment advantage, respondent argued:

> That Congress did not intend that the net profit or loss resulting from the normal every-day operation of a business should qualify for the special treatment accorded to capital gains or losses is fully apparent from the exceptions stated in Section 117, which include (1) stock in trade, (2) inventory, (3) property held for sale to customers in the ordinary course of a trade or business, and (4) depreciable property used in the trade or business.
>
> * * *
>
> . . . [T]he exclusions from the capital asset concept of Section 117 must be broadly applied to effectuate the basic Congressional purpose.

Brief for Respondent at 18, 21, *Corn Products*, 350 U.S. 46, Appendix A at A-1, A-2.

This Court adopted respondent's analysis with only minor changes:

> Congress intended that profits and losses arising from the everyday operation of a business be considered as ordinary income or loss rather than capital gain or loss. The preferential treatment provided by § 117 applies to transactions in property which are not the normal source of business income. It was intended "to relieve the

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[1] *Commissioner v. Bagley & Sewall Co.*, 221 F.2d 944, 947 (2d Cir. 1955), (taxpayer allowed ordinary loss treatment on sale of bonds purchased as required security for performance of contract); *Commissioner v. Western Wine & Liquor Co.*, 18 T.C. 1090 (1952) (taxpayer, a wholesale liquor dealer, was allowed ordinary loss treatment on sale of stock purchased to insure right to purchase bulk whiskey), *appeal dismissed on government motion*, 205 F.2d 420 (8th Cir. 1953), *acq.*, 1958-1 C.B. 6; *Hogg v. Allen*, 105 F. Supp. 12 (M.D. Ga. 1952), *aff'd sub nom. Edwards v. Hogg*, 214 F.2d 640 (5th Cir. 1954). *See also* Rev. Rul. 58-40, 1958-1 C.B. 275.

> taxpayer from ... excessive tax burdens on gains resulting from a conversion of capital investments, and to remove the deterrent effect of those burdens on such conversions." *Burnet v. Harmel*, 287 U.S. at 106. Since this section is an exception from the normal tax requirements of the Internal Revenue Code, the definition of a capital asset must be narrowly applied and its exclusions interpreted broadly. This is necessary to effectuate the basic congressional purpose. This Court has always construed narrowly the term "capital assets" in § 117. See *Hort v. Commissioner*, 313 U.S. 28, 31; *Kieselbach v. Commissioner*, 317 U.S. 399, 403.

Corn Products, 350 U.S. at 52, 76 S.Ct. at 24.

Five years after the *Corn Products* doctrine was enunciated, this Court decided *Commissioner v. Gillette Motor Transport Co.*, 364 U.S. 130, 80 S.Ct. 1497, 4 L.Ed.2d 1617 (1960), a case involving the taxability of compensation received for a temporary taking of real estate during wartime. Respondent argued that the term "property" in Section 117(a)(1) was not to be read as "all-inclusive". Brief for Respondent at 17, *Gillette Motor*, 364 U.S. 130, Appendix B, *infra*, at B-1. Recognizing the continued viability of respondent's argument this Court held that:

> While a capital asset is defined in § 117(a)(1) as "property held by the taxpayer," it is evident that not everything which can be called property in the ordinary sense *and which is outside the statutory exclusions* qualifies as a capital asset. This Court has long held that the term "capital asset" is to be construed narrowly in accordance with the purpose of Congress to afford capital-gains treatment only in situations typically involving the realization of appreciation in value accrued over a substantial period of time, and thus to ameliorate the hardship of taxation of the entire gain in one year. *Burnet v. Harmel.* ... Thus the Court has held that an unexpired lease, *Hort v. Commissioner*, ... corn futures, *Corn Products Co. v. Commissioner*, ... and oil payment rights,

> *Commissioner v. P.G. Lake, Inc.*, . . . are not capital assets even though they are concededly "property" interests in the ordinary sense. (Citations omitted.) (Emphasis supplied.)

Gillette Motor, 364 U.S. at 134-35, 80 S.Ct. at 1500-01.

As explained in *Gillette Motor*, the *Corn Products* doctrine reflects the essential division between property acquired for business purposes and property acquired for investment purposes.[2] *Gillette Motor*, 364 U.S. at 135, 80 S.Ct. at 1501. The Commissioner has adopted the same distinction:

> [G]ains and losses resulting from the "operation of a business" must be distinguished from gains and losses incurred in "conversion of capital investments".

Rev. Rul. 72-238, 1972-1 C.B. 65, 66. In this ruling, the Commissioner relied on *Gillette Motor* and *Corn Products* and concluded that the gain realized when a creditor bank purchased mortgaged property at a foreclosure sale at a bid price less than the fair market value of the property was taxable as ordinary income. *See* Treas. Reg. § 1.166-6(b)(1); Rev. Rul. 72-238, 1972-1 C.B. at 66 (quoting *Gillette Motor*, 364 U.S. at 134, 80 S.Ct. at 1500). The Commissioner quoted the language in *Gillette Motor* stating that " . . . not everything which can be called property in the ordinary sense and which is outside the statutory exclusions qualifies as a capital asset." The Commissioner based his holding on the historical distinction between property "acquired and held . . . for profit and investment" and property acquired and held for business purposes:

> The gain realized by the bank on the exchange of the note receivable cannot be viewed as representing an "appreciation in value accrued over a substantial period of time".

Rev. Rul. 72-238, 1972-1 C.B. at 66.

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[2] *See also Commissioner v. Brown*, 380 U.S. 563, 570, 572, 85 S.Ct. 1162, 1165-67, 14 L.Ed.2d 75 (1965).

Respondent's position in *Corn Products* and *Gillette Motor* is equally applicable to stock as to the "property" at issue in those cases. Respondent's reliance upon *Western Wine* in its brief in *Corn Products* (Brief for Respondent at 22, *Corn Products*, 350 U.S. 46, Appendix A at A-3), and its later acquiescence in that case, 1958-1 C.B. 6, is significant. *See also* Rev. Rul. 58-40, 1958-1 C.B. 275. It makes clear that respondent has not historically been wed to the notion, adopted by the Eighth Circuit in *Arkansas Best*, 800 F.2d at 221, that stock can never be other than a capital asset. For respondent to contend otherwise suggests a shortsighted view of the history and application of the principle established in *Corn Products*.[3]

Rev. Ruls. 58-40 and 72-238, *supra*, are not isolated circumstances. Respondent has applied the *Corn Products* rationale in a variety of other situations:

1. Rev. Rul. 70-64, 1970-1 C.B. 36 (losses incurred by members of agricultural cooperative upon redemption of qualified written notices of allocation were ordinary losses);

2. Rev. Rul. 72-179, 1972-1 C.B. 57 (losses incurred by textile company on hedges to insure against market fluctuations in the price of cotton were ordinary losses);

3. Rev. Rul. 75-13, 1975-1 C.B. 67 (citing *Corn Products* and holding that the predominant motive of the purchaser and the surrounding circumstances are

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[3] In this regard, Amicus takes issue with the contention in Respondent's Brief in Response to the Petition for Certiorari in this case:

> [T]here is no justification for viewing the Court's opinion [in *Corn Products*] as creating a judge-made exception to the specific definition of "capital asset".

Br. at 12. In fact, what the Court did in *Corn Products* was to follow respondent's urging and adopt the *Western Wine* rationale.

important in determining whether worthless stock held by a corporate officer was acquired and held for investment or business reasons);

4. Rev. Rul. 78-94, 1978-1 C.B. 58, revoking Rev. Rul. 75-13, (adopts the holding in *W. W. Windle Co. v. Commissioner*, 65 T.C. 694, *appeal dismissed*, 550 F.2d 43 (1st Cir. 1976), *cert. denied*, 431 U.S. 966, 97 S.Ct. 2923, 53 L.Ed.2d 1062 (1977), which restricts application of *Corn Products* to cases where there is no "substantial" investment motive); and

5. Rev. Rul. 78-414, 1978-2 C.B. 214 (motive important in analyzing tax treatment of taxpayer's purchase of commodity futures contracts for future delivery of Treasury bills).

II.

CORN PRODUCTS IS CONSISTENT WITH DECISIONS WHICH APPLY THE INTERNAL REVENUE CODE IN HARMONY WITH THE UNDERLYING CONGRESSIONAL INTENT

The decision in *Corn Products* is consistent with a series of cases, beginning even before *Burnet v. Harmel*, 287 U.S. 103, 53 S.Ct. 74, 77 L.Ed. 199 (1932), which have sought to interpret rather than apply dogmatically the provisions of the Code. These decisions are reflective of a Congressionally approved purpose that when applying the various provisions of the Code, courts should render decisions in harmony with the legislative intent rather than in lockstep with the literal language of statutory provisions.

Helvering v. Alabama Asphaltic Limestone Co., 315 U.S. 179, 62 S.Ct. 540, 86 L.Ed. 775 (1942), involved application of the "continuity of interest" doctrine first enunciated in *Pinellas Ice & Cold Storage Co. v. Commissioner*, 287 U.S. 462, 53 S.Ct. 257, 77 L.Ed. 428 (1933). That doctrine provides that a transaction will not be treated as a tax-free reorganization unless the seller maintains a

continuing interest in the reorganized entity. In *Alabama Asphaltic*, the Court described the prior cases in the following language:

> From the *Pinellas* case (287 U.S. 462) to the *LeTulle* case (308 U.S. 415) it has been recognized that a transaction may not qualify as a "reorganization" under the various revenue acts though the literal language of the statute is satisfied.

Alabama Asphaltic, 315 U.S. at 182, 62 S.Ct. at 542-43. This Court clearly recognized that to require only literal compliance with the statute would defeat Congress' purpose.

Judge Hand made the identical point in the Second Circuit's opinion in *Helvering v. Gregory*, 69 F.2d 809 (2d Cir. 1934), *aff'd, Gregory v. Helvering*, 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596 (1935), the case in which this Court engrafted the "business purpose" doctrine onto the reorganization provisions of the Code. *See Gregory v. Helvering*, 293 U.S. at 470, 55 S.Ct. at 268. In describing a transaction which met the literal requirements of a "reorganization" but which lacked an apparent business purpose, Judge Hand wrote:

> Nevertheless, it does not follow that Congress meant to cover such a transaction, not even though the facts answer the dictionary definitions of each term used in the statutory definition.

Helvering v. Gregory, 69 F.2d at 810.

These decisions, like *Corn Products*, affirm the courts' role in the application and interpretation of the Code. Without them, the Code would need to be longer and more complex than it already is. Respondent recognized this fact in its brief to this Court in *Corn Products* when it said:

> Congress has made it as clear as the limitations of language permit (short of a detailed enumeration of every conceivable kind of transaction which might be found in every conceivable kind of business) that profits and losses derived from the normal operation of a business are not to receive the

> special tax considerations reserved for [capital assets]. . . .

Brief for Respondent at 27, *Corn Products*, 350 U.S. 46, Appendix A at A-4. The increasing complexity of the business world makes this statement at least as true, if not more true, in 1987 as it was in 1955.

Alabama Asphaltic and *Gregory v. Helvering* are instructive in the present case for other reasons. First, the continuity of interest, business purpose and *Corn Products* doctrines were adopted by this Court at respondent's urging. Second, the continuity of interest and business purpose doctrines are each more than fifty-years old. During their existence, the reorganization sections of the Code have been amended numerous times and their precision, breadth and complexity have increased.[4] Despite these legislative enactments, the continuity of interest and business purpose doctrines remain vital and acknowledged additions to the Code definitions of reorganizations.[5]

The *Corn Products* doctrine though of more recent

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[4] Some of the amendments speak directly to aspects of the doctrines, *e.g.*, Section 368(a)(1)(B) incorporated one aspect of the continuity of interest doctrine by restricting the permissable consideration in stock for stock reorganizations to "voting stock". Section 368(a)(2)(B) was added to permit minor amounts of cash to be used in stock for asset reorganizations.

[5] In his article, *Definitional Problems in Capital Gains Taxation*, 69 HARV. L. REV. 985, 995 (1956), Professor Surrey compared the facts in *Gregory v. Helvering* with situations involving "corn futures, . . . government bonds, and . . . debentures," and stated . . . that the latter set of examples –

> are not tax avoidance distortions. They involve everyday business-motivated transactions. But they forced the judicial action taken in reference to them because of the failure of Congress to face up realistically to the tremendous classification problem inherent in the attempted division between "investment" and "business". Put more narrowly, the decisions represent the courts' view

(Footnote continued on the following page)

vintage (32 years) has, until now, been recognized by the courts and the respondent as a vital constructional element in the implementation of the acknowledged legislative intent of restricting capital asset treatment to investment-type activities. The original need for the *Corn Products* doctrine remains. Both respondent's argument and the Court's decision in *Corn Products* were in harmony with the overriding theme that the substance or business purpose of a transaction controls its taxability.

III.

CORN PRODUCTS IS CONSISTENT WITH THE LEGISLATIVE HISTORY OF SECTION 1221 AND ITS PREDECESSOR PROVISIONS

The legislative history of Section 1221, and its predecessor provisions, supports the decision in *Corn Products*.

Section 206(a)(6) of the Revenue Act of 1921, ch. 136, § 206(a)(6), 42 Stat. 233 (1921), the original predecessor of Section 117(a) of the 1939 Code and Section 1221 of the 1954 (and 1986) Code, recognized the distinction between property "acquired and held by taxpayer for profit and investment" and other property. The statutory language provided as follows:

> The term "capital assets" as used in this section means *property acquired and held by the taxpayer for profit and investment for more than two years* (whether or not connected with his trade or

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5 *(Continued)*

> that Congress has not realistically faced the problem and therefore did not desire to be taken literally when it used the broad term "property" in section 1221. The courts are willing to rescue Congress from its statutory strait jacket.

To the extent respondent relied upon *Bagley & Sewall* (bonds) and *Western Wine* (stock) in *Corn Products* (corn futures), (Appendix A at A-3), it agreed with Prof. Surrey's analysis and endeavored to apply a common sense interpretation to the basic statutory language.

> business), but does not include property held for his family, or stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the end of the taxable year. (Emphasis added.)

Revenue Act of 1921, ch. 136, § 206(a)(6), 42 Stat. 233 (1921).

On February 7, 1924, H.R. 6715 was introduced in the House of Representatives. Section 208(a)(8) of H.R. 6715 provided as follows:

> The term "capital assets" means *property held by the taxpayer for profit or investment for more than two years* (whether or not connected with his trade or business) but does not include stock in trade of the taxpayer or other property held by the taxpayer primarily for sale. (Emphasis added.)

H.R. 6715, 68th Cong., 1st Sess. § 208(a)(8) (1924).

H.R. 6715 was adopted by the House, with amendments, and introduced in the Senate on February 29, 1924. The proposed bill, as amended in the House and adopted by the Senate, provided as follows:

> The term "capital assets" means *property held by the taxpayer for more than two years* (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale in the course of his trade or business. (Emphasis added.)

Revenue Act of 1924, ch. 234, § 208(a), 43 Stat. 263 (1924).

Thus, Congress in 1924 dropped the qualitative "acquired and held . . . for profit and investment" test and left the mechanical "held . . . for more than two years" test for determining whether property should be regarded as a "capital asset". This Court has stated, however, that the 1921 provision was "reenacted in 1924 without material change." *Burnet v. Harmel*, 287 U.S. at 106, 53 S.Ct. at 75.

Thus, while the statutory language was modified in 1924, the Court did not consider the original intent of the provision – to provide special tax treatment for assets "acquired and held ... for profit and investment", in contrast to assets acquired for use in a business – to have changed.

The only noteworthy addition to the "capital asset" provision in 1924 was with respect to "property held by the taxpayer primarily for sale in the course of his trade or business." In commenting upon the 1924 addition to the language of the 1921 Act, the House Ways and Means Committee stated:

> The last part of the definition of capital assets is changed to *remove any doubt* as to whether property which is held primarily for resale constitutes a capital asset whether or not it is the type of property which under good accounting practice would be included in the inventory. (Emphasis added.)

H. REP. No. 179, 68th Cong., 1st Sess. 19 (1924), *reprinted in* 1939-1 (Part 2) C.B. 241, 255.

The "remove any doubt" language reflects a Congressional acknowledgment that the exceptions to the "capital asset" definition enumerated in Section 208(a)(8) of the 1924 Act were not intended to be exclusive. As originally enacted as Section 206(a)(6) of the 1921 Act, the "capital asset" definition was intended to apply to "property acquired and held by the taxpayer for profit and investment." *See Burnet v. Harmel*, 287 U.S. at 106, 53 S.Ct. at 75.

The enactments of Congress in 1921 and 1924, the pertinent legislative history and this Court's previous analysis do not reflect an intent by Congress to enact a literal, unbending provision. The legislative history of this provision, both prior to and subsequent to the *Corn Products* decision, is replete with opportunities when Congress could have modified the principle announced in *Burnet v. Harmel*

and enlarged in *Corn Products* and *Gillette Motor*, that in applying the statutory definition of "capital assets" and its enumerated exclusions, the distinction between property "acquired and held ... for profit and investment" and property acquired for business uses must be paramount.[6]

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[6] There have been enacted frequent legislative modifications to the list of exceptions to the term "capital assets" since 1924. In 1934, the "*to customers* in the *ordinary* course of his trade or business" language was added. (Modifications italicized.) Revenue Act of 1934, ch. 277, § 117(b), 48 Stat. 714 (1934); H. REP. NO. 1385, 73d Cong., 2d Sess. 22 (1934), *reprinted in* 1939-1 (Part 2) C.B. 627, 632. The mechanical "for more than two years" test was also deleted in the Revenue Act of 1934. *Id.* According to the House Report, the "two year" period previously in effect could only be defended on the "ground of expediency". H. REP. NO. 704, 73d Cong., 2d Sess. 10 (1934), *reprinted in* 1939-1 (Part 2) C.B. 554, 562. The predecessor to current Section 1221(2) was added in the Revenue Acts of 1938 and 1942. Revenue Act of 1938, ch. 289, § 117(a) (1), 52 Stat. 500 (1938); Revenue Act of 1942, ch. 619, § 151(a), 56 Stat. 846 (1942). In 1950, Congress excluded copyrights, as well as literary, musical and artistic compositions from the "capital asset" definition. Revenue Act of 1950, ch. 994, § 210(a), 64 Stat. 933 (1950); H. REP. NO. 3124, 81st Cong., 2d Sess. 27 (1950).

In the 1954 recodification, Section 1221(4), relating to accounts and notes receivable, was added to the list of property specifically excluded from the term "capital assets". Internal Revenue Code of 1954, ch. 736, § 1221(4), 68A Stat. 321 (1954).

Section 1221(3) was further amended in 1969 with the addition of an exception relating to letters or memoranda created by or for a taxpayer. Tax Reform Act of 1969, Pub. L. No. 91 – 172, § 514(a), 83 Stat. 643 (1969); *see Morrison v. Commissioner*, 71 T.C. 683 (1979), *aff'd*, 611 F.2d 98 (5th Cir. 1980).

Present Section 1221(5) was added in the Tax Reform Act of 1976. Pub. L. No. 94 – 455, § 2132(a), 90 Stat. 1925 (1976); S. REP. NO. 1236, 94th Cong., 2d Sess. 532 (1976). Section 1221 was amended again in 1981 with the deletion of former Section 1221(5) relating to short-term government obligations issued at a discount. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 505(a), 95 Stat. 338 (1981); H. REP. NO. 215, 97th Cong., 1st Sess. 260 (1981).

IV.

DESPITE FREQUENT LEGISLATIVE ACTIVITY CONCERNING THE DEFINITION OF "CAPITAL ASSETS", NO EFFORT HAS BEEN MADE TO REFORM OR RESTRICT THE SCOPE OF *CORN PRODUCTS*

Recent legislative history makes clear that where Congress has disapproved of a judicial interpretation, it has not been reluctant to change the judicially created rule. The doctrine that a corporation does not realize taxable income upon distributing appreciated property to its shareholders, set forth in *General Utilities & Operating Co. v. Helvering*, 296 U.S. 200, 56 S.Ct. 185, 80 L.Ed. 154 (1935), and thereafter codified in Sections 311(a)(2), 336 and 337 of the Internal Revenue Code of 1954, was eliminated in the Internal Revenue Code of 1986. Tax Reform Act of 1986, Pub. L. No. 99-514, § 631, 100 Stat. 2085 (1986).

In the significant legislative enactments which have occurred since the *Corn Products* and *Gillette Motor* decisions, Congress has never sought to cut back on the Court's holdings. Rather, the enactments regarding Section 1221, *see supra* note 6, have dealt with the periphery of the "capital asset" definition and have not sought to negate the *Corn Products* doctrine.[7]

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[7] Significantly, in Rev. Rul. 75-533, 1975-2 C.B. 359, 360, the Commissioner stated as follows with respect to another of his interpretations of the Code:

> [S]ection 20.2055-1 has existed in substantially the same form since 1921 and has been consistently construed and applied by the courts on many occasions. Such continuous existence and consistent application of the unambiguous regulation, together with reenactment of the construed legislation, "bespeaks congressional approval," *Corn Products Refining Co. v. Commissioner*, 350 U.S. 46, 53 (1955), and the regulation has "acquired the force of law," *Cammarano v. United States*, 358 U.S. 498, 510 (1958).

V.

THE DECISION OF THE EIGHTH CIRCUIT IN *ARKANSAS BEST* IS IN ERROR

Whether the *Corn Products* doctrine applies in the circumstance of *Arkansas Best* is as much a factual as a legal determination. One thing is certain, however, the decision of the Eighth Circuit is in error.[8] The application of Section 1221 should not be determined by its literal language. In its brief in *Corn Products*, the government cited approvingly cases, *see supra* note 1, where taxpayers had acquired securities (bonds and stocks) for business rather than investment purposes. As the government argued:

> Significant, too, are decisions refusing capital gain or loss treatment to property which served a purpose directly related to the earning of normal business profits, even though the property did not come within the literal language of the statutory exceptions to the capital asset definition.

Brief for Respondent at 22, *Corn Products*, 350 U.S. 46, Appendix A at A-3.

Respondent's present effort to move away from the position which it urged this Court to accept in 1955 in *Corn Products* and in 1960 in *Gillette Motor* and which it has adopted in various revenue rulings, *supra* pp. 6–8, should be rejected by the Court. As the Court said in *Fribourg Navigation Co. v. Commissioner*, 383 U.S. 272, 86 S.Ct. 862, 15 L.Ed.2d 751 (1966):

> The Commissioner's position represents a sudden and unwarranted volte-face from a consistent administrative and judicial practice . . .
>
> * * *
>
> Congress repeatedly re-enacted the depreciation

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[8] Indeed, Amicus would suggest that the Court does not have to reach the underpinnings of the *Corn Products* doctrine to decide the instant case. It can conclude that the Eighth Circuit's literal approach is in error and follow the factual conclusion of the Tax Court regarding taxpayer's "business" intent.

> provision without significant change. Thus, beyond the generally understood scope of the depreciation provision itself, the Commissioner's prior long-standing and consistent administrative practice must be deemed to have achieved congressional approval.

383 U.S. at 279, 283, 86 S.Ct. at 867, 869.

While the change in position as respects the *Corn Products* doctrine is arguably not as egregious as that in *Fribourg*, on account of respondent's earlier effort to persuade this Court to revisit *Corn Products* (*see* Petition for Certiorari filed in *Waterman, Largen & Co. v. United States*, 419 F.2d 845 (Ct. Cl. 1969), *cert. denied*, 400 U.S. 869, 91 S.Ct. 103, 27 L.Ed.2d 109 (1970), (filed July 17, 1970), *but cf.* the revenue rulings cited and discussed *supra* pp. 6–8, which were issued *after* respondent's petition in *Waterman, Largen* was filed), the fundamental fact remains that Congress has never taken up the cudgel for the Commissioner on this issue.[9] Further, it is not apparent that the Commissioner has made any serious effort to reform or modify the *Corn Products* doctrine through legislation in the more than 30 years since its argument was accepted by this Court. To paraphrase the Court's decision in *Commissioner v. National Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 149, 94 S.Ct. 2129, 2137, 40

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[9] In *Commissioner v. Brown*, 380 U.S. at 579, 85 S.Ct. at 1170, a case involving the application of Section 1221(3) of the Internal Revenue Code of 1954, in the context of a sale of a business to an exempt organization, this Court stated:

> [I]f the Commissioner's approach is intended as a limitation upon the tax treatment of sales generally, it represents a considerable invasion of current capital gains policy, a matter which we think is the business of Congress, not ours.

See also American Automobile Assn. v. United States, 367 U.S. 687, 697, 81 S.Ct. 1727, 1732, 6 L.Ed.2d 1109, *reh'g denied*, 368 U.S. 870, 82 S.Ct. 24, 76 L.Ed.2d 70 (1961), where the Court left to Congress "the fashioning of a rule, which, in any event, must have wide ramifications."

L.Ed.2d 717 (1974), the Commissioner has freely argued for a certain judicial interpretation; that interpretation was accepted by this Court in *Corn Products* and *Gillette Motor* and has become a fundamental precept of the "capital asset" definition; accordingly, the Commissioner should be obliged to abide by that interpretation in the absence of Congressional action to the contrary.

CONCLUSION

For the foregoing reasons, Amicus Curiae respectfully urges the Court to reaffirm the principle that the decisions in *Corn Products* and *Gillette Motor* are essential elements in the distinction made in Section 1221 of the Internal Revenue Code, and its predecessor provisions, between property acquired and held for investment purposes and property acquired and held for business purposes.

Respectfully submitted,

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APPENDIX A

In The Supreme Court of the United States

OCTOBER TERM, 1955

No. 20

CORN PRODUCTS REFINING COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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* * *

Brief, at 18-19:

The definition of a capital asset in Section 117 embodies an unusual draftsman's technique — the definition is specific only in stating what is *not* a capital asset. The congressional purpose in granting special tax preference to gains from, and of limiting the deductions of losses on, the sale or exchange of capital assets must be gleaned from the exceptions enumerated in the statute, *i. e.*, from the kinds of gains or losses which do not qualify for special consideration.

That Congress did not intend that the net profit or loss resulting from the normal every-day operation of a business should qualify for the special treatment accorded to capital gains or losses is fully apparent from the exceptions stated in Section 117, which include (1) stock in trade, (2) inventory, (3) property held for sale to customers in the ordinary course of a trade or business, and (4) depreciable property used in the trade or business.

The taxpayer's claim to capital asset treatment of its futures transactions rests on a simple syllogism: its futures contracts were "property"; they were not its stock in trade; they did not (strictly) form part of its inventory; they were not being held for sale to customers and they were not subject to depreciation. With these statements we agree. But we disagree with the conclusion that taxpayer draws, namely, that since the futures contracts do not come within the precise words of the enumerated exceptions, they must be classified as capital assets. (Br. 13–15, 32–33, 36–37.)

* * *

Brief, at 21-23:

This approach has two aspects, in view of the form of Section 117. On the one hand, as this Court indicated in *Burnet v. Harmel*, 287 U. S. 103, the usual rule that statutory exceptions from income tax under the provisions of the Internal Revenue Code are to be stictly construed, requires that the capital asset definition be narrowly applied. See *Ogle v. Helvering*, 77 F. 2d 338, 339 (C. A. 2d); *Sloane v. Commissioner*, 188 F. 2d 254 (C. A. 6th). As a necessary corollary, the exclusions from the capital asset concept of Section 117 must be broadly applied to effectuate the basic Congressional purpose.

Thus, this Court and the lower courts have consistently refused, in a wide variety of circumstances, to treat as capital gain, or as a return of a capital investment, receipts which are not the kind of gain for which the statute intended preferential treatment. In many situations capital gain or loss has been denied, even though, superficially, the transactions qualified under the literal language of the capital–gains provisions. See *e.g.*, *Kieselbach v. Commissioner*, 317 U. S. 399 (portion of lump–sum condemnation award which represented compensation for delay in payment taxed as ordinary income); *Hort v. Commissioner*, 313 U. S. 28 (lump sum received for cancellation of lease regarded as a substitute for rent,

taxable as ordinary income, rather than as proceeds from sale of lease); *Helvering v. Smith*, 90 F. 2d 590 (C. A. 2d), and *Doyle v. Commissioner*, 102 F. 2d 86 (C. A. 4th) (sale of right to receive legal fee for services rendered, taxed as ordinary income rather than as sale of capital asset); *Rhode's Estate v. Commissioner*, 131 F. 2d 50 (C. A. 6th) (sale of right to receive previously declared dividend held not taxable as sale of capital asset); *Fisher v. Commissioner*, 209 F. 2d 513 (C. A. 6th), certiorari denied, 347 U.S. 1014 (sale of past–due interest taxable as ordinary income); *Shuster v. Helvering*, 121 F. 2d 643 (C. A. 2d) (payment received on cancellation of employment contract taxable as ordinary income).

Significant, too, are decisions refusing capital gain or loss treatment to property which served a purpose directly related to the earning of normal business profits, even though the property did not come within the literal language of the statutory exceptions to the capital asset definition. *Commissioner v. Bagley & Sewall Co.*, 221 F. 2d 944, 947 (C. A. 2d) (loss on United States bonds purchase in order to meet contract requirement that they be posted as security for performance of the contract and sold when released in accordance with the contract, held deductible as ordinary loss). See also, *Commissioner v. Western Wine & Liquor Co.*, 18 T. C. 1090, appeal dismissed, 205 F. 2d 420 (C. A. 8th); *Clark v. Commissioner*, 19 T. C. 48, appeal dismissed June 18, 1953 (C. A. 9th), and *Hogg v. Allen*, 105 F. Supp. 12 (M. D. Ga.), affirmed on this point, *sub. nom. Edwards v. Hogg*, 214 F. 2d 640 (C. A. 5th) (taxpayers who were in business of buying and selling whiskey and who purchased shares of stock in distilling companies in order to have opportunity of purchasing, on favorable terms, whiskey which was in short supply did not suffer capital loss on later disposition of the shares of stock, the loss being held to constitute a part of the cost of acquiring the inventory of whiskey); *Helvering v. Community Bond & Mortgage Corp.*, 74 F. 2d 727 (C. A. 2d) (loss on stock of

another corporation purchased in order to dissolve it, thus cancelling an unprofitable contract with such corporation, held deductible as a business expense).

* * *

Brief, at 27-28:

Recognizing that the construction of Section 117 for which it contends is opposed to the established rule applicable to hedging transactions, taxpayer now seeks to attack the validity of that rule, even as it applies to "true" hedging operations (see Br. 18). It is led to do this because futures contracts do not, in the strict sense of the words, represent stock in trade, inventory, property held for sale to customers, or depreciable property used in a trade or business, i. e., strictly speaking, as urged by taxpayer, they do not fall within the broad categories of property excluded from the definition of a capital asset. But in this attack, taxpayer must fail. As this Court has indicated, the capital gains provisions must be read in the light of their purpose and in the context of the pattern of the income tax law which taxes ordinary income at full rates and grants exceptional treatment to capital gains and losses. So read, it becomes evident that Congress has made it as clear as the limitations of language permit (short of a detailed enumeration of every conceivable kind of transaction which might be found in every conceivable type of business) that profits and losses derived from the normal operation of a business are not to receive the special tax considerations reserved for what, generally, may be described as investments. "The purpose is to protect 'investment property' as distinguished from 'stock in trade,' or property bought and sold for a profit." *Rollingwood Corp. v. Commissioner*, 190 F. 2d 263, 266 – 267 (C. A. 9th). *Accord: Kenan v. Commissioner*, 114 F. 2d 217, 220 (C. A. 2d); *Commissioner v. Shapiro*, 125 F. 2d 532, 535 – 536 (C. A. 6th); *Rieger v. Commissioner*, 139 F. 2d 618, 621 (C. A. 6th); *Watson v. Commissioner*, 197 F. 2d 56, 58 (C. A. 9th), affirmed, 345 U. S. 544.

* * *

APPENDIX B

In The Supreme Court of the United States

OCTOBER TERM, 1959

No. 359

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

GILLETTE MOTOR TRANSPORT, INC.

WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE PETITIONER

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* * *

Brief, at 17-19:

2. The definition of the term "capital assets"

Section 117(a)(1) defines the term "capital assets" generally as "property" held by the taxpayer.[7] However, "property" as used in that section is not all – inclusive. The Congressional purpose in allowing a lower rate of taxation on the gain resulting from the conversion of capital assets is to ameliorate the burden which would be incurred by a taxpayer should that gain be classified as ordinary income in the year of a sale or exchange when the gain is due to appreciation in value over the period of investment, and to remove the deterrent effect of that burden on such conversions. *Commissioner v. P. G. Lake, Inc.*, 356 U.S. 260, 265, 266, rehearing denied, 356 U.S. 964; *Corn Products Co. v. Commissioner*, 350 U.S. 46, 52, rehearing

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[7] Subparagraphs (A) and (B) of Section 117(a) (1) contain certain exclusions from this definition.

denied, 350 U.S. 943; *Burnet v. Harmel*, 287 U.S. 103, 106, 111; *United States v. Snow*, 223 F. 2d 103, 109 (C.A.9), certiorari denied, 350 U.S. 831; *Fisher v. Commissioner*, 209 F. 2d 513, 514 (C.A. 6), certiorari denied, 347 U.S. 1014; *Boomhower v. United States*, 74 F. Supp. 997, 1001 (N. D. Iowa). This Court, in order to conform the statutory definition of "capital assets" to that Congressional purpose, has always narrowly construed the definition. *Corn Products Co. v. Commissioner*, *supra*, p. 52; *Commissioner v. P. G. Lake, Inc*, *supra*, p. 265.

The problem often presented, and which is raised in this case, is to determine whether a conversion of a taxpayer's capital investment has occurred. The controlling distinction (based on the principles discussed in the previous paragraph) is that, when gain is realized upon the conversion of assets which have appreciated in value and which otherwise meet the definition of "capital assets", the gain is treated as capital gain whereas gain realized from the *use* of such an asset is treated as ordinary income. The latter type of transaction does not result in the burden aimed at by the capital gains provisions, and is therefore not accorded capital gain treatment. *Commissioner v. P.G. Lake, Inc.*, *supra*, p. 266; *Burnet v. Harmel*, *supra*, p. 106; *United States v. Snow*, *supra*, p. 109; *Fisher v. Commissioner*, *supra*, p. 514; *Mathey v. Commissioner*, 10 T.C. 1099, 1105, affirmed, 177 F. 2d 259 (C.A. 1), certiorari denied, 339 U.S. 943; *Eaton v. Commissioner*, 10 T.C. 869, 881-882; Rev. Rul. 38, 1953-1 Cum. Bull. 16, 17. Cf. *Anderson v. Helvering*, 310 U.S. 404, 407; *Raytheon Production Corp. v. Commissioner*, 144 F. 2d 110, 113 (C.A. 1), certiorari denied, 323 U.S. 779; *Marcalus Manufacturing Co. v. Commissioner*, 30 T.C. 1345, 1350–1353, affirmed *per curiam sub nom. Marcal Pulp & Paper, Inc. v. Commissioner*, 268 F. 2d 739 (C.A. 3), certiorari

denied, December 14, 1959, No. 516, this Term.[8] Another way of putting the difference is to use the distinction between a "tree" and its "fruit" found in the assignment–of–income cases (see, for example, *Lucas v. Earl*, 281 U.S. 111, 115). In those terms, the conversion of the "tree" into gain results in capital gain; the conversion of the "fruit" of a tree into gain results in ordinary income.

These general principles are fully applicable to the present case. Although the intangible right of the taxpayer to use, for the period of ten months, assets in which it owned the fee may be considered property in one sense, it is not "property" which can be converted in the "capital gains" sense – as we shall show. The basic error of the court below is its refusal to recognize this distinction.

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[8] In a discussion by Professor Stanley S. Surrey of the results that would flow from an interpretation giving the word "property" in Section 117(a)(1) an all – inclusive meaning, the example of a claim for salary is used, but comparable reasoning would apply in the case of a claim for compensation for the use of property. Surrey's observations are as follows (*Definitional Problems in Capital Gains Taxation*, 69 Harv. L. Rev. 985, 988 fn. 7 (1956)):

"Thus, since a claim to salary is certainly 'property' in one sense of the term, the claim to salary would in that sense be a capital asset. While payment of the salary would not produce a capital gain because of the "sale or exchange" requirement under the existing interpretation of "exchange," a sale of the claim would produce a capital gain under this interpretation of property. And, if this interpretation were adopted, we might well find a national brokerage business developing overnight through which employees sold their salary claims. In effect, the "sale or exchange" requirement would not suffice to stem the capital gain flood waters if "capital asset" were all – inclusive. * * * "